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The World Viewed from Wall Street

Robert Rubin
In an Uncertain World. Random House, New York

U.S Treasury Secretary Robert Rubin was a central player in a critical phase of globalisation – coping with the enormous expansion in international capital flows in the 1990s. "In an Uncertain World" covers much else besides this, but its main interest to Australians may be in this issue. The volatility of these flows was the key factor in the Mexican Crisis of 1994-5 ("the first crisis of the twenty-first century"), which in turn was the precursor to the Asian Crisis of 1997-8. This episode has left scars on our region and unfinished business in terms of the challenges which volatile international capital flows present to a well-functioning closely integrated world. If, as Rubin argues, such crises will be repeated, his book is important to us in Australia because of its insights into the nature of the problem and the light it sheds on how the US might respond.

Rubin began his time with the Clinton administration as head of the National Economic Council, but became Treasury Secretary just as the Mexican crisis was breaking. Earlier Latin American crises had been characterised by profligate domestic policies, so the appropriate prescription was to correct the domestic policies, with foreign funding needed to buy time while the fix was put in place. The new crisis – characterised by foreign capital flight - was more analogous to a bank run, where the critical issue was the restoration of confidence. "Lend freely" has long been the central banker's response to domestic bank runs, and Rubin's team correctly identified that, in the absence of an international central bank with capacity to "lend freely", the US had to do the job. The amount needed was far in excess of anything the International Monetary Fund could provide, and in any case the Fund was geared up for the traditional-style crises. This money was needed urgently, for quick disbursement, while the Fund was accustomed to providing its lending in staged tranches, in "carrot and stick" fashion as the domestic policy reforms were put in place. Nor could there be a precise calculation of a balance of payments "gap" to needed funding. Significant over-funding was needed to convince investors that their money was safe, but if this could be swiftly mobilised and confidence restored, the money would be quickly repaid or, as in Mexico, would not be needed in full. Given the novelty of this type of crisis, the prescription was remarkably apposite. The stumbling-block was to persuade a reluctant Congress to provide the money. In the face of this reluctance (and arguments that this was a "bail-out" for the benefit of Rubin's former colleagues in Wall Street), the Administration by-passed the formal Congressional approval process.

The episode illustrated the diagnostic capacity, vigour and speed of the response to a clear perception of American interests. It also illustrates the US's readiness (even pre-George W Bush) to handle international problems in a largely-unilateral way and the closeness of the relationship with the IMF. Lastly, it is a reminder of how cumbersome the democratic process can be in the face of urgent problems.

All these characteristics were illustrated again in the Asian crisis three years later. But the balance of forces was different, so the US response was different, and less effective (far less, in the case of Indonesia). When the Asian crisis began in Thailand in mid 1997, the US declined to join the bilateral support efforts which supplemented the IMF money. The diagnosis was the same as in Mexico – capital flight was a central element. So too was the prescription: treat this as a bank run, by providing enough funding to reassure investors. Whereas Mexico had $40 billion available (and only needed half of that), Thailand had $17 billion – and this was to be doled out by the Fund in tranches over time. By the time Indonesia succumbed to the contagion a couple of months later, the US joined the bilateral support effort, but in such a half-hearted way (constrained by Congress' annoyance at having been by-passed in the earlier Mexican rescue) that it undermined the overall package. When South

Korea became the next victim, US interests were much more directly affected – not only because Korea was larger, but there were 35,000 US troops stationed there. The IMF provided an amount equal to nearly 2000 percent of Korea's quota (compared with around 500 percent for Thailand and Indonesia) and revised its "hands-off" attitude to foreign debt, actively orchestrating the stand-still of Korea's foreign bank debt – a key element in Korea's rapid recovery.

What should Australia (and our Asian neighbours) learn from this? First, the central role of the US in IMF decisions: with just 18 percent of the vote, the US can dominate the Fund's decisions. Secondly, even when the US administration is run by "the best and brightest", they are often learning as they go along, with surprisingly little local knowledge of Asia. Thirdly, the US will be driven by what Rubin calls the Powell Doctrine – that it acts "only when American interests are at stake". Thailand's problems were seen as being (to echo Chamberlain before WWII) "in a far-away country between people about whom we know nothing". When it comes to seeking assistance from the IMF, countries of the American continent will have the US to argue their case (as it has done more recently for Argentina and Brazil), and Eastern Europe will have the Europeans as their champion. But S-E Asia may have no champion, unless Japan finds a more effective voice.

Despite Rubin's strong links with financial markets (or perhaps because he knows them so well), he is ready to accept their imperfections rather than simply blame the afflicted countries. He quotes Anwar Ibrahim as saying that "for every bad borrower, there is a bad lender". He explicitly recognises that "no country in the world had perfect policies. ... No matter how sound economic policies and practices may appear, every country falls far short of perfection – including our own". He notes how little the foreign investors knew about the countries they were investing in, and indeed how little they knew about their own exposures. "The entire Asian experience left me with the view that future financial crises are almost surely inevitable and could be even more severe….While many – particularly in the financial community – seemed to believe that financial crises were solely a function of the structural and policy problems of developing countries, I believe that the excesses of credit and investment in good times were also to blame".

Rubin talks interestingly on the differences between public and corporate decision making, and at length on the role of uncertainty in decision-making (hence the title). Ex-post failure is commonly – but incorrectly - seen as confirming that the ex-ante policy was wrong: "If the odds are calculated accurately at three to one, you'll lose one time in four. Unfortunately Washington – the political process and the media – judges decisions based solely on outcomes. … This can easily lead to undue risk aversion on the part of public officials. The same issue exists in the private sector…but the private sector somewhat more frequently recognises the need to look beyond the outcome." He displays a wider view of the political problem, advocating a "parallel agenda" in addition to what might be called narrowly-rational economics. Here is an intelligent, thoughtful, public-minded, pragmatic, broad-thinking internationalist, ably assisted by the "Dream Team" of bureaucrats and academic economists, making a fair fist of the new challenges of globalisation (with the notable exception of Indonesia), while wrestling with the domestic constraints. One can almost forgive the pretensions of the Time magazine cover – included among the photographs in the book - with its "Committee to Save the World", made up of Rubin, Fed Reserve Chairman Alan Greenspan and Larry Summers, his deputy at the time and later his successor. At least it shows who was calling the shots.

In contrast to the recent book of his successor Paul O'Neil, there is not much "kiss and tell here": no criticism of President Clinton, who he obviously admires; no mention of the controversial Japanese-sponsored idea of an Asian Monetary Fund; and some studious reading-between-the lines is needed to get even a hint that there might have been active discussion among the Administration advocating "regime change" in Indonesia. Colleagues are warmly praised, and opponents largely ignored. Policy comes smoothly out of a collegiate decision process.

There is, in addition to the issues covered here, extensive treatment of Rubin's earlier life and substantial sections on domestic economic policy making (including discussion of the US's own crisis – the Long Term Credit Management debacle, although there is not much here on the share market bubble), heart-felt criticism of the Bush tax cuts and concerns about both the budget deficit and the current account deficit. But the strongest message for an Australian reader is how fragile and tenuous is America's relationship with the outside world. He reminds (or warns) us of American insularity – "for most Americans, the global economy remains an abstraction, with little meaning for their daily lives". As proof that Rubin himself does not share this view, his concluding chapter is entitled "A Declaration of Interdependence", in support of globalisation.